

National Credit Union Administration

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credit union, or its agent, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book Entry Securities Transfer System; and the Federal credit union, or its agent, receives a daily assessment of the market value of the collateral, including accrued interest, and maintains adequate margin that reflects a risk assessment of the collateral and the term of the loan;

(3) Any cash the Federal credit union receives is subject to the borrowing limit specified in Section 107(9) of the Act, and any investments the Federal credit union purchases with that cash are permissible for Federal credit unions and mature no later than the maturity of the transaction; and

(4) The Federal credit union has executed a written loan and security agreement with the borrower.

(f)(1) *Trading securities.* A Federal credit union may trade securities, including engaging in when-issued trading and pair-off transactions, so long as the Federal credit union can show that it has sufficient resources, knowledge, systems, and procedures to handle the risks.

(2) A Federal credit union must record any security it purchases or sells for trading purposes at fair value on the trade date. The trade date is the date the Federal credit union commits, orally or in writing, to purchase or sell a security.

(3) At least monthly, the Federal credit union must give its board of directors or investment-related committee a written report listing all purchase and sale transactions of trading securities and the resulting gain or loss on an individual basis.

[68 FR 32960, June 3, 2003, as amended at 77 FR 31991, May 31, 2012]

§ 703.14 Permissible investments.

(a) *Variable rate investment.* A Federal credit union may invest in a variable rate investment, as long as the index is tied to domestic interest rates and not, for example, to foreign currencies, foreign interest rates, or domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this

part, the U.S. dollar-denominated London Interbank Offered Rate (LIBOR) is a domestic interest rate.

(b) *Corporate credit union shares or deposits.* A Federal credit union may purchase shares or deposits in a corporate credit union, except where the NCUA Board has notified it that the corporate credit union is not operating in compliance with part 704 of this chapter. A Federal credit union's aggregate amount of perpetual and nonperpetual capital, as defined in part 704 of this chapter, in one corporate credit union is limited to two percent of the federal credit union's assets measured at the time of investment or adjustment. A Federal credit union's aggregate amount of contributed capital in all corporate credit unions is limited to four percent of assets measured at the time of investment or adjustment.

(c) *Registered investment company.* A Federal credit union may invest in a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for Federal credit unions.

(d) *Collateralized mortgage obligation/real estate mortgage investment conduit.* A Federal credit union may invest in a fixed or variable rate collateralized mortgage obligation/real estate mortgage investment conduit.

(e) *Municipal security.* A Federal credit union may purchase and hold a municipal security, as defined in Section 107(7)(K) of the Act, only if a nationally-recognized statistical rating organization has rated it in one of the four highest rating categories.

(f) *Instruments issued by institutions described in Section 107(8) of the Act.* A Federal credit union may invest in the following instruments issued by an institution described in Section 107(8) of the Act:

- (1) Yankee dollar deposits;
- (2) Eurodollar deposits;
- (3) Banker's acceptances;
- (4) Deposit notes; and
- (5) Bank notes with original weighted average maturities of less than 5 years.

(g) *European financial options contract.* A Federal credit union may purchase a European financial options contract or

a series of European financial options contracts only to fund the payment of dividends on member share certificates where the dividend rate is tied to an equity index provided:

(1) The option and dividend rate are based on a domestic equity index;

(2) Proceeds from the options are used only to fund dividends on the equity-linked share certificates;

(3) Dividends on the share certificates are derived solely from the change in the domestic equity index over a specified period;

(4) The options' expiration dates are no later than the maturity date of the share certificate.

(5) The certificate may be redeemed prior to the maturity date only upon the member's death or termination of the corresponding option;

(6) The total costs associated with the purchase of the option is known by the Federal credit union prior to effecting the transaction;

(7) The options are purchased at the same time the certificate is issued to the member.

(8) The counterparty to the transaction is a domestic counterparty and has been approved by the Federal credit union's board of directors;

(9) The counterparty to the transaction:

(i) Has a long-term, senior, unsecured debt rating from a nationally-recognized statistical rating organization of AA– (or equivalent) or better at the time of the transaction, and the contract between the counterparty and the Federal credit union specifies that if the long-term, senior, unsecured debt rating declines below AA– (or equivalent) then the counterparty agrees to post collateral with an independent party in an amount fully securing the value of the option; or

(ii) Posts collateral with an independent party in an amount fully securing the value of the option if the counterparty does not have a long-term, senior unsecured debt rating from a nationally-recognized statistical rating organization.

(10) Any collateral posted by the counterparty is a permissible investment for Federal credit unions and is valued daily by an independent third

party along with the value of the option;

(11) The aggregate amount of equity-linked member share certificates does not exceed the credit union's net worth;

(12) The terms of the share certificate include a guarantee that there can be no loss of principal to the member regardless of changes in the value of the option unless the certificate is redeemed prior to maturity; and

(13) The Federal credit union provides its board of directors with a monthly report detailing at a minimum:

(i) The dollar amount of outstanding equity-linked share certificates;

(ii) Their maturities; and

(iii) The fair value of the options as determined by an independent third party.

(h) *Mortgage note repurchase transactions.* A federal credit union may invest in securities that are offered and sold pursuant to section 4(5) of the Securities Act of 1933, 15 U.S.C. 77d(5), only as a part of an investment repurchase agreement under § 703.13(c), subject to the following conditions:

(1) The aggregate of the investments with any one counterparty is limited to 25 percent of the credit union's net worth and 100 percent of its net worth with all counterparties;

(2) At the time a federal credit union purchases the securities, the counterparty, or a party fully guaranteeing the transaction, must have outstanding debt with a long-term rating no lower than A– or its equivalent and outstanding debt with a short-term rating, if any, no lower than A–1 or its equivalent;

(3) The federal credit union must obtain a daily assessment of the market value of the securities under § 703.13(c)(1) using an independent qualified agent;

(4) The mortgage note repurchase transaction is limited to a maximum term of 90 days;

(5) All mortgage note repurchase transactions will be conducted under tri-party custodial agreements; and

(6) A federal credit union must obtain an undivided interest in the securities.

(i) *Zero-coupon investments.* A federal credit union may only purchase a zero-

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coupon investment with a maturity date that is no greater than 10 years from the related settlement date, unless authorized under § 703.20 or otherwise provided in this paragraph. A federal credit union that received a composite CAMEL rating of “1” or “2” for the last two (2) full examinations and maintained a net worth classification of “well capitalized” under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained “well capitalized” for the six (6) immediately preceding quarters after applying the applicable RBNW requirement, may purchase a zero-coupon investment with a maturity date that is no greater than 30 years from the related settlement date.

(j) *Commercial mortgage related security (CMRS).* A federal credit union may purchase a CMRS permitted by Section 107(7)(E) of the Act; and, pursuant to Section 107(15)(B) of the Act, a CMRS of an issuer other than a government-sponsored enterprise enumerated in Section 107(7)(E) of the Act, provided:

(1) The CMRS is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization;

(2) The CMRS meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of commercial mortgage related security as defined in § 703.2 of this part;

(3) The CMRS’s underlying pool of loans contains more than 50 loans with no one loan representing more than 10 percent of the pool; and

(4) The aggregate amount of private label CMRS purchased by the federal credit union does not exceed 25 percent of its net worth, unless authorized under § 703.20 or as otherwise provided in this subparagraph. A federal credit union that has received a composite CAMEL rating of “1” or “2” for the last two (2) full examinations and maintained a net worth classification of “well capitalized” under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained “well capitalized” for the six (6) immediately preceding quarters

after applying the applicable RBNW requirement, may hold private label CMRS in an aggregate amount not to exceed 50% of its net worth.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39831, July 1, 2004; 71 FR 76124, Dec. 20, 2006; 75 FR 64826, Oct. 20, 2010; 77 FR 31991, May 31, 2012]

EFFECTIVE DATE NOTE: At 77 FR 74110, Dec. 13, 2012, § 703.14 was amended by revising paragraphs (e), (g)(9), (g)(11), (h)(1), (h)(2), and (j)(1), effective June 11, 2013. For the convenience of the user, the added and revised text is set forth as follows:

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(e) *Municipal security.* A Federal credit union may purchase and hold a municipal security, as defined in section 107(7)(K) of the Act, only if it conducts and documents an analysis that reasonably concludes the security is at least investment grade. The Federal credit union must also limit its aggregate municipal securities holdings to no more than 75 percent of the Federal credit union’s net worth and limit its holdings of municipal securities issued by any single issuer to no more than 25 percent of the Federal credit union’s net worth.

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(g) * * *

(9) The counterparty to the transaction meets the minimum credit quality standards as approved by the Federal credit union’s board of directors.

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(11) The aggregate amount of equity-linked member share certificates does not exceed 50 percent of the Federal credit union’s net worth;

* * * * *

(h) * * *

(1) The aggregate of the investments with any one counterparty is limited to 25 percent of the Federal credit union’s net worth and 50 percent of its net worth with all counterparties;

(2) At the time the Federal credit union purchases the securities, the counterparty, or a party fully guaranteeing the counterparty, must meet the minimum credit quality standards as approved by the Federal credit union’s board of directors.

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(j) * * *

(1) The Federal credit union conducts and documents a credit analysis that reasonably concludes the CMRS is at least investment grade.

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§ 703.15 Prohibited investment activities.

Adjusted trading or short sales. A Federal credit union may not engage in adjusted trading or short sales.

§ 703.16 Prohibited investments.

(a) *Derivatives.* A Federal credit union may not purchase or sell financial derivatives, such as futures, options, interest rate swaps, or forward rate swaps. This prohibition does not apply to:

(1) Any derivatives permitted under §§ 701.21(i) and 703.14(g) of this chapter;

(2) Embedded options not required under GAAP to be accounted for separately from the host contract; and

(3) Interest rate lock commitments or forward sales commitments made in connection with a loan originated by the Federal credit union.

(b) *Mortgage servicing rights.* A Federal credit union may not purchase mortgage servicing rights as an investment but may perform mortgage servicing functions as a financial service for a member as long as the mortgage loan is owned by a member;

(c) *Stripped mortgage backed securities (SMBS).* A Federal credit union may not invest in SMBS or securities that represent interests in SMBS except as described in paragraphs (1) and (3) below.

(1) A Federal credit union may invest in and hold exchangeable collateralized mortgage obligations (exchangeable CMOs) representing beneficial ownership interests in one or more interest-only classes of a CMO (IO CMOs) or principal-only classes of a CMO (PO CMOs), but only if:

(i) At the time of purchase, the ratio of the market price to the remaining principal balance is between .8 and 1.2, meaning that the discount or premium of the market price to par must be less than 20 points;

(ii) The offering circular or other official information available at the time of purchase indicates that the notional

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principal on each underlying IO CMO should decline at the same rate as the principal on one or more of the underlying non-IO CMOs, and that the principal on each underlying PO CMO should decline at the same rate as the principal, or notional principal, on one or more of the underlying non-PO CMOs; and

(iii) The credit union staff has the expertise dealing with exchangeable CMOs to apply the conditions in paragraphs (e)(1)(i) and (e)(1)(ii) of this section.

(2) A Federal credit union that invests in an exchangeable CMO may exercise the exchange option only if all of the underlying CMOs are permissible investments for that credit union.

(3) A Federal credit union may accept an exchangeable CMO representing beneficial ownership interests in one or more IO CMOs or PO CMOs as an asset associated with an investment repurchase transaction or as collateral in a securities lending transaction. When the exchangeable CMO is associated with one of these two transactions, it need not conform to the conditions in paragraphs (e)(1)(i) and (ii) of this section.

(d) *Other prohibited investments.* A Federal credit union may not purchase residual interests in collateralized mortgage obligations, real estate mortgage investment conduits, or small business related securities.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39832, July 1, 2004; 77 FR 31991, May 31, 2012]

§ 703.17 Conflicts of interest.

(a) A Federal credit union's officials and senior management employees, and their immediate family members, may not receive anything of value in connection with its investment transactions. This prohibition also applies to any other employee, such as an investment officer, if the employee is directly involved in investments, unless the Federal credit union's board of directors determines that the employee's involvement does not present a conflict of interest. This prohibition does not include compensation for employees.

(b) A Federal credit union's officials and employees must conduct all transactions with business associates or